



BUSINESS LAW SECTION

UNIFORM COMMERCIAL CODE COMMITTEE

THE STATE BAR OF CALIFORNIA

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December 5, 2007

Assemblyman Ira Ruskin
California State Assembly
Capitol Office
State Capitol
P.O. Box 942849
Sacramento, CA 94249-0021

Re: Conflict In California Statutes Treating "Full Payment" Checks

Dear Assemblyman Ruskin:

You have asked the Uniform Commercial Code Committee (the "UCC Committee") of the Business Law Section of the California State Bar to analyze and provide its recommendations with respect to the apparent conflict between California Uniform Commercial Code ("CUCC") Section 3311 and California Civil Code ("CCC") Section 1526 concerning the consequences of the negotiation of a "full payment" check.

We have reviewed decisions of the California and federal courts discussing the conflict as well as language and official comments to other relevant provisions of the CUCC. Based on our research, we conclude that CUCC §3311 and CCC §1526 are in irreconcilable conflict and that this conflict is a source of ongoing confusion to parties seeking to conduct business in California. We recommend that the conflict be resolved by the repeal of CCC §1526.

Analysis of CUCC §3311 and CCC §1526

The Statutory Provisions

CCC §1526, enacted in 1987, provides in pertinent part:

(a) Where a claim is disputed or unliquidated and a check or draft is tendered by the debtor in settlement thereof in full discharge of the claim, and the words "payment in full" or other words of similar meaning are notated on the check or draft, the acceptance of the check or draft does not constitute an accord and satisfaction if the creditor protests against accepting the tender in full payment by striking out or otherwise deleting that notation or if the acceptance of the check or draft was inadvertent or without knowledge of the notation.

CUCC §3311, enacted in 1993, provides in pertinent part:

(a) If a person against whom a claim is asserted proves that (1) that person in good faith tendered an instrument to the claimant as full satisfaction of the claim, (2) the amount of the claim was unliquidated or subject to a bona fide dispute, and (3) the claimant obtained payment of the instrument, the following subdivisions apply.

(b) Unless subdivision (c) applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

For your convenience, we include appendices that contain the complete text of CCC §1526 and CUCC §3311 as well as other statutes, court decisions and other materials referred to in this letter.

A Brief History Of The “Full Payment” Check In California Law

The “full payment” check has a substantial if somewhat erratic history under California law. The common law rule developed by the courts treated the tender of the full payment check consistent with contract law principles: this common law rule provided that where a good faith dispute existed as to the amount due, a debtor could tender a check with a restrictive notation to the effect of “payment in full” as a proposed accord and satisfaction, and the creditor’s negotiation of the check - - so long as it was clear that the check was in fact tendered in full satisfaction of the claim - - was deemed a binding acceptance notwithstanding any reservation of rights by the creditor. In other words, tender of a “full payment” check was an offer, and the creditor had no power to unilaterally rewrite the terms of such offer by reserving rights while simultaneously accepting the tender of payment. California followed this common law rule. See, e.g., Potter v. Pacific Coast Lumber Co., 37 Cal.2d 592 (1951).¹

The original adoption of the Uniform Commercial Code (“UCC”) by the various states (enacted by California in 1963) had an unintended impact on the common law rule on the full payment check. Section 1-207 of the UCC as originally enacted² provided that a party could with an explicit reservation of rights accept performance from an obligee that it did not consider to fully comply with the obligee’s full obligation without prejudicing its rights and remedies with respect to full compliance. A split developed among jurisdictions on the issue of whether §1-207 displaced the common law rule on full payment checks so as to permit the creditor to negotiate

¹ For a history of the common law rule in California, see Hull & Sharma, Satisfaction Not Guaranteed: California’s Conflicting Law on the Use of Accord and Satisfaction Checks, 33 Loyola L.A. L. Rev. (1999) (hereinafter, “Hull & Sharma Article”).

² This provision is now codified as CUCC §1-308(a), but for purposes of this letter it is referred to as §1-207 throughout.

the check without prejudicing its rights by explicitly reserving its rights through an appropriate notation on the check. The minority rule held that §1-207 did indeed displace the common law rule so as to permit the creditor to negotiate the check while preserving its rights as to the disputed balance by simply striking the restrictive notation. The majority rule held that §1-207 did not displace the common law rule, and California followed the majority rule.³ However, jurisdictions adopting the minority rule included some commercially significant states such as New York and Illinois.

In 1987, California enacted as CCC §1526 a bill sponsored by Senator Quentin Kopp. We have not been able to identify any helpful definitive legislative history for §1526, although some commentators have suggested that the concern underlying Senator Kopp's bill was that unscrupulous debtors employed the "full payment" check to "chisel down" legitimate debts.⁴

In 1993, California enacted the 1990 Amendments to the Uniform Commercial Code, which included both §3311 and an amendment to §1-207 that expressly states that §1-207 does not apply to an accord and satisfaction. The Official Comment 3 to §1-207 makes clear that the addition was intended to address the split in precedent that had developed with respect to the consequences of the negotiation of a payment in full check. It appears that at the time of the passage of the 1990 amendments by the California legislature, the sponsors sought the repeal of §1526, but Senator Kopp blocked the effort, and the available legislative history for CUC §3311 contains no explicit reference to §1526.⁵

Thus, history of the full payment check in California can be summarized as follows: California followed the common law rule that negotiation of a full payment check bound the creditor to the accord and satisfaction. When the split in authority developed with respect to whether §1-207 displaced the common law rule, California followed the majority rule that §1-207 did not displace the common law rule. By enacting §1526, California effectively adopted the minority rule under which the creditor could negotiate the check without prejudicing its right to the disputed balance by expressly reserving its rights. Enactment of §3311 in 1993 should have returned California to the majority rule.⁶ The only problem is that the California legislature left §1526 embodying the minority rule on the books.

³ See, e.g., Connecticut Printers, Inc. v. Gus Kroesen, Inc., 134 Cal.App.3d (1982).

⁴ See Scott J. Burnham, Accord and Satisfaction in California: A Trap for the Unwary, 30 Santa Clara L. Rev. 473, 495 (1990).

⁵ See Hull & Sharma Article, p.30.

⁶ We note that §3311(c) includes exceptions to the general rule in §3311(b) that in general terms provide checks otherwise delivered in accordance with §3311(b) do not fully discharge a debt if (i) the claimant notifies the debtor of the address to which communications concerning the disputed debt should be sent and the debtor does not follow those instructions or (ii) check repayment is tendered within 90 days. While practitioners may debate the appropriateness of those exceptions, they are consistent with the national Uniform Commercial Code, as to which amendments are approached on a national level in order to retain consistency among the states on Uniform Commercial Code matters.

CCC §1526 and CUCC §3311 Are In Irreconcilable Conflict

The two reported court decisions that address the interplay of §1526 and §3311 -- one by a federal district court and one by a California appellate court -- have both concluded that the statutory provisions are in irreconcilable conflict.⁷ This conclusion is evident: Both statutes purport to prescribe the consequence of a creditor's negotiation of a "full payment" check, but the consequences prescribed by the respective statutes are diametrically opposed. A rule that provides that negotiation of the check effects an accord and satisfaction cannot be reconciled with a rule that provides that the creditor/recipient can avoid the accord and satisfaction by unilaterally striking out the condition of payment.

Applying the rule of statutory construction to the effect that "when two acts governing the same subject matter cannot be reconciled, the later in time will prevail over the earlier," the courts in both Directors Guild and Woolridge held that the provisions of §3311 prevail over §1526.

Approaches To Resolving The Conflict

We considered three possible approaches to the conflict between §1526 and §3311:

1. Take No Action On The Assumption That §1526 Is A "Dead Letter."

The reported decisions are consistent in holding that the provisions of §3311 prevail over §1526 based on the rule of statutory construction that dictates that the later enacted statute must prevail over the earlier statute.⁸ Inasmuch as §1526 has already been recognized as superseded and is now merely a "dead letter," the California legislature might conclude that the status quo is adequate and no action is required.

The shortcoming in this approach is that neither of the reported decisions is the decision of the California Supreme Court, and another court could again reexamine the issue and apply a different rule of statutory construction to reach a contrary result. For example, inasmuch as §1526 applies only to checks and not all instruments, and further requires the restrictive notation to be on the check itself, a court could conclude that §1526 is the more specific statute, and should accordingly control as the more specific statute over the more general statute. Similarly, a court could conclude that the rule of statutory construction that gives precedence to the later enactment as the last statement of the legislative intent does not apply in these circumstances: the legislature was keenly aware of the conflict at the time of enactment as witnessed by the attempt to repeal §1526, but consciously and

⁷ See Directors Guild of America v. Harmony Pictures, Inc., 32 F.Supp.2d 1184, 1189-92 (C.D. Cal. 1998); Woolridge v. J.F.L. Electric, Inc., 96 Cal.App.4th Supp. 52, 59-60 (2002) (citing and adopting reasoning of Directors Guild).

⁸ The current Desktop edition of West's California Civil Code notes that §1526 has been held to be superseded by §3311 in the Woolridge decision.

deliberately did not act to repeal §1526.⁹ Thus, taking no action with respect to the conflict would leave unresolved an issue that is a source of continuing confusion and result in inconsistent decisions and uncertainty. Accordingly, a “no action” approach to this conflict is not appropriate.

2. Amend Either Or Both §1526 And §3311 To Harmonize The Two Statutes.

An attempt could be made to limit the scope of the respective statutes so that §1526 applies in certain circumstances and §3311 in other circumstances. For example, the creditor in Woolridge argued that §3311 should not apply in a noncommercial transaction. There are two defects in such an approach. First, the fundamental approaches of the two statutes are too disparate to be bridged: no principled rationale can be articulated to justify one consequence in one set of circumstances with the opposite consequence in other circumstances. For example, to limit §3311 to “commercial transactions” would only serve to engender substantial confusion and resulting litigation over when the transaction was “commercial” or “noncommercial.” Second, any attempt to limit the scope of §3311 is likely to represent a material departure from the provisions of the uniform statute. All of the public policy reasons favoring uniformity that underlie the enactment of the Uniform Commercial Code militate against materially altering the scope of §3311.

3. Repeal §1526.

The repeal of §1526 would eliminate the confusion and uncertainty caused by the current conflict and would advance the interests of uniformity and the attendant certainty of laws represented by §3311. In addition, if the law were clear that a creditor could negotiate a “full payment” check without prejudicing its rights to any further amount claimed due simply by striking out or otherwise protesting the restrictive notation, a debtor would have no incentive to tender the check in the first instance because negotiation of the check would not resolve the dispute. Under §3311, the debtor has an incentive to tender the payment while the creditor can always reject the proposed accord and satisfaction and pursue its full rights by not negotiating the check: under §1526, the creditor will have no such choice to make because the debtor will have no incentive to tender the check in the first instance.

Summary of Conclusions and Recommendation

CCC §1526 and CUCC §3311 each prescribe the consequences of a claimant’s negotiation of a check with a “payment in full” or similar restrictive notation tendered as an accord and satisfaction of a disputed claim. CCC §1526 generally permits the creditor to negotiate the check and retain the proceeds without becoming bound under the accord and satisfaction so long as the

⁹ See Hull & Sharma Article, pp. 31-33, concerning uncertainties in applying the rules of statutory construction to the conflict between §1526 and §3311.

creditor protests or strikes out the restrictive notation. CUCC 3311 takes an opposite approach: so long as the restrictive notation is conspicuous, such that the creditor is deemed to have knowledge of it, the creditor is deemed to have accepted the accord and satisfaction by its negotiation of the instrument.

California state and federal courts have correctly determined that the two statutes are in irreconcilable conflict. Moreover, the fundamental approaches of the two statutes are so at odds that no amendment to either or both statutes would resolve the conflict without materially altering the present scope and effect of CUCC §3311. The strong policy interest in maintaining uniformity among the provisions of the Uniform Commercial Code as enacted by the states militates against any material amendment of CUCC §3311. Accordingly, we recommend the repeal of CCC §1526 as the only principled means of resolving the conflict.

Please note that positions set forth in this letter are only those of the UCC Committee. They have not been adopted by the Business Law Section or its overall membership, or by the State Bar's Board of Governors or its overall membership, and are not to be construed as the position of the State Bar of California. Membership on the UCC Committee and in the Business Law Section is voluntary, and funding for their activities, including all legislative activities, is obtained entirely from voluntary sources.

Respectfully yours,

/s/

Jan Kosel, UCC Committee Co-Chair

/s/

Wansun Song, UCC Committee Co-Chair

Appendices

- A: Statutory Provisions
- B: Court Decisions
- C: Law Review Articles